STATE OF CALIFORNIA
ENERGY RESOURCES CONSERVATION
AND DEVELOPMENT COMMISSION

In the Matter of: Informational Proceeding and Preparation of the 2004 Integrated Energy Policy Report (IEPR) Update	Docket No. 03-IEP-1

COMMENTS OF WEST COAST POWER ON THE COMMITTEE DRAFT REPORT

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Date: October 13, 2004

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West Coast Power LLC ("WCP") is grateful for the opportunity to comment on the Committee Draft Report ("Report") in connection with the 2004 Update of the Commission's Integrated Energy Policy Report ("IEPR"). The final version of the 2004 Update to the IEPR is vitally important to California because it will be submitted to the Governor and the Legislature, and it will form the framework for future energy policy development and future energy legislation.

I. INTRODUCTION

The IEPR had identified and addressed many of the important issues confronting California's energy future. WCP is particularly gratified that the Committee has had the foresight to examine specifically the status of the aging power plants in California and the role they will continue to play in meeting the needs of California's need for a reliable supply of electricity. The Committee is to be congratulated for questioning the conventional wisdom that aging power plants are inefficient and dirty, for studying the issue carefully in the Staff White Paper on Aging Power Plants,[1] and for reaching the conclusion that these plants operate cleanly and efficiently and that they play a crucial role in maintaining the grid-wide and local reliability

[1] WCP is the indirect owner of several of the aging plants that were the subject of the staff's analysis. WCP is equally owned by indirect subsidiaries of Dynegy Inc. and NRG Energy Inc., and WCP's four subsidiaries own and operate 2,295 MW of electric generation in Southern California, including the El Segundo, Long Beach, and Encina plants.

of the electric system. The Report recognizes that older plants continue to make a vital contribution to meeting the energy needs of California and that it is essential to retain existing plants until newer plants can take their place.

As these Comments will demonstrate, it follows from these points that it is equally essential to maintain existing plant sites as optimal locations for new generating units. Existing generation sites provide a prime opportunity for siting more efficient replacement units with minimal infrastructure changes and significant improvements in environmental performance. In this proceeding, constructing new generation on the sites of existing plants has be referred to as "repowering."

Existing generation will play a critical role between now and when the next wave of new generating resources comes online in 2006–08, or later. In addition, aging plants provide the state with a cost-effective insurance policy against the effects of low rainfall and low hydroelectric power production, unusually hot weather, deratings of transmission lines, and other unexpected occurrences. The Committee has confronted the unpleasant reality that many owners and operators of older units, including WCP, are rapidly approaching the point where final decisions must be made about the future of their units and sites. In the absence of clear decisions on critical issues, these owners and operators may be compelled by economic necessity to shut down their plants and make other use of their sites. As WCP noted in its previous comments on the 2003 IEPR, over 10,000 MW of existing electric generation in California are at risk for premature economic retirement.[2] Since October 2003, at least 1,200 MW of existing plants have been retired or mothballed. In the absence of clear policy decisions regarding the existing units, and specifically an express policy preference for redevelopment at existing sites, the pace of these retirements is likely to accelerate.

As the Report acknowledges, the loss of these units and sites would pose a serious threat to the reliability of the California electric grid, and one of the most valuable contributions of the Report is raising the awareness of this impending crisis.

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[2] See Comments of West Coast Power on the Draft Committee Report of the Ad Hoc Integrated Energy Policy Report Committee, Oct. 10, 2003.

One general comment on the Report is that in certain areas, such as the discussion of capacity markets, the Report should have more detailed and in-depth discussion. The final version of the Report will be submitted to the Governor and the Legislature, and it will form the framework for future legislation and energy policy development. It is important to have enough detailed discussion of certain key issues to guide the development of legislation and policy.

II. COMMENTS ON THE REPORT

WCP is pleased to see that the Committee, after intensive study, has arrived at many of the same conclusions as WCP. In particular, WCP supports many of the Report's key conclusions, as briefly discussed in the following sections.

A. California must make better use of its existing fleet of power plants.

The Committee recognizes that aging power plants play at least three roles in the California electricity system:

- They provide local reliability services in select areas of the state through the California Independent System Operator's ("CAISO's") Reliability Must-Run ("RMR") contracts;
- They contribute to regional and statewide reliability by acting as generating reserve margins during periods of peak load, primarily hot summer periods, and in system emergencies; and
- They help alleviate transmission system congestion by offsetting regional transmission congestion, or intertie overloading, with generation at or near load.[3]

The Committee's recognition of the value of aging power plants could not have come at a more crucial point in the development of the state's electricity resources. Although often derided as "inefficient and dirty,"[4] these aging power plants in fact play a crucial role in maintaining the reliability of the electric grid. As summarized in the Executive Summary of the

[3] Report, p. 11.
[4] See, *e.g.*, Energy Action Plan, p. 6.

Report:

> . . . if significant numbers of aging power plants continue to retire between now and 2008, reserve margins in the state could become dangerously thin.
>
> * * *
>
> Currently, aging power plants appear to be an important element in addressing congestion on the southern portions of the CA ISO system and assuring that supplies from outside the greater Los Angeles basin can be reliably delivered to load centers.
>
> * * *
>
> . . . additional steps must be taken to assure that California has adequate supplies over the next few years. The consequences of not taking actions to address potential supply shortfalls from possible retirements [of aging power plants] would place consumers and businesses at unacceptable risks.
>
> * * *
>
> . . . the state needs to shore up its electricity supplies, including generation from aging power plants, to maintain adequate reserve margins for peak demand periods and to provide regional and local reliability services.[5]

The Report and the analysis supporting the report have clarified that "many of the aging power plants (30 out of 50) have emission control technologies that are comparable to those of the new combined cycles. Because similar Selective Catalytic Reduction technology is used on the combined cycles and the aging plant's steam boilers, the difference in emissions reflects only the differences in the relative heat rates or efficiency of the two types of power plants."[6] The Report also notes that the impression that aging power plants are inefficient also needs to be corrected to reflect the operation of these units as load-following units: "[O]lder technology steam boilers like the aging power plants have a relatively constant efficiency across broad operating ranges while the efficiency of new combined cycle units, though high, drops off substantially at lower operating levels." By debunking the myths surrounding aging power

[5] Report, p. 3.
[6] Report, p. 15.

plants and by documenting the contribution these aging power plants make to electric supply and reliability, the Committee has made a valuable contribution to the energy debate in California.

B. Maintaining aging plants' capacity during the transition and the threat of retirements

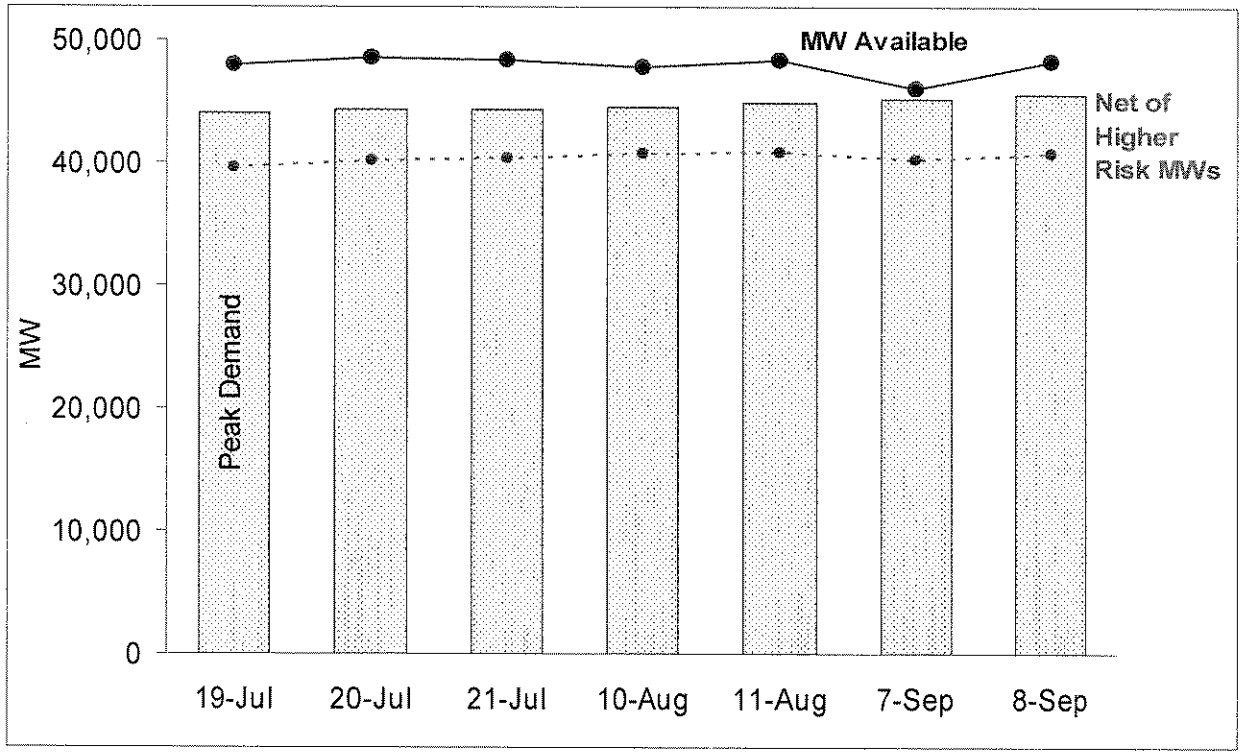
As the Report recognizes, it is vitally important to keep the aging plants' capacity available while we navigate the transition away from the state's reliance on Department of Water Resources contracts for the bulk of California's energy needs and on RMR" contracts for grid support.

However, the goal of maintaining this crucial capacity is challenged by the threat that many of these plants will be compelled by the forces of economics to retire during the period when their capacity is most needed. As the Report recognizes, "Aging power plant owners may choose to retire these units because they are unable to fully recover their costs during the relatively few hours of the year they can operate."[7] In the same vein, the Report concludes, "California has a significant number of aging power plants that may be retired in the near-term because they do not fully recover their on-going fixed costs in the current market, since they operate infrequently."[8]

[7] Report, p. 3.
[8] Report, p. 10.

The magnitude of this problem is illustrated by the staff's study and conclusion that about 9,000 MW of aging plants' capacity is at medium to high risk of retiring by 2008.[9] Even without these retirements, the state's reserve margins during summer peaks during 2005-2008 could be very thin, and with these retirements, adverse weather conditions could reduce reserve margins to critical levels as soon as next summer.[10] The potential magnitude of the effect of retirements on reserve margins is shown graphically in the following chart:

CAISO Resource Balance on Record-Breaking Days



"Peak Demand" as reported in CAISO VP Jim Detmer's presentation at the IEP Annual Meeting (9/27/04)
"MW Available" from CAISO's "2004 Summer Assessment," April 16, 2004, Table III-1, net actual CAISO reported outages.
"Net of Higher Risk MWs" equals MW Available minus Higher Risk Capacity from CEC's "Integrated Energy Policy Report: 2004 Update" Committee Report, September, 2004. Table 2-1.

The potential consequences of these retirements are stated starkly in the Report: "Preliminary transmission system analysis shows that retirements within the Los Angeles Basin sub-region could reduce the capability of importing power into the area, as well as potentially

[9] Report, p. 11.
[10] Report, pp. 11-12.

reduce generating reserve margins to unacceptable levels."[11]

Fortunately, the Committee also recommends some initiatives that if promptly implemented might help defer the retirement of at least some of the aging power plants' critical capacity.

C. Resource adequacy requirements may improve the prospects for continued operation of aging plants

The California Public Utilities Commission ("CPUC") has adopted resource adequacy requirements for the utilities under its jurisdiction. The current resource adequacy requirements, however, are not scheduled to be effective until 2008, and many parties have questioned whether the delay in implementing these requirements will result in the retirements of aging power plants that might otherwise be able to provide some of the reserve resources needed to meet this requirement. In response to this concern, a proposal is pending before the CPUC that would accelerate the implementation of the resource adequacy requirement to June 2006.

The Committee recognizes that "The CPUC's proposed decision on resource adequacy requirement takes a significant step forward in stabilizing California's electricity market and providing adequate future supplies."[12] Unfortunately, the CPUC did not vote on the proposal to accelerate the resource adequacy requirement at its business meeting of October 7, and the next opportunity for it to consider this matter is not until October 28. Meanwhile, Governor Schwarzenegger affirmed his support for resource adequacy in his on October 8 letter to the San Diego Tribune:

> Getting more power plants online requires a regulatory structure that emphasizes adequate reserve margins, long-term contracts and competitive procurement. In April, I called upon the California Public Utilities Commission to move up the requirement that all electricity sellers provide a minimum 15 percent energy reserve level. This strong reserve margin will provide a "sunny day" reserve of energy so that even during peak power demand, Californians will never have to worry about blackouts. This will be the most stringent reserve requirement in the nation.

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[11] Report, p. 25.
[12] Report, p. 20.

As WCP points out below, time is of the essence with regard to the future of many of the aging power plants. Further delay of a vote on the decision to accelerate the implementation of the resource adequacy requirement could be detrimental to the reliability of California's electric supply.

D. Development of a capacity market

WCP wholeheartedly supports the Committee's conclusion that a tradable capacity market can help meet state's proposed resource adequacy requirements, and in the process it might also help ensure the availability of critical capacity from aging power plants for the next few years. As the Report notes:

> Ultimately, well-established capacity markets would allow aging power plants to compete with other existing generation and new power plant construction. Aging plant owners maintain that the location of their facilities near load is of higher value than generation more remotely located. A capacity market, in combination with resource adequacy requirements and deliverability standards, should send proper signals to the market about the value of these generating units.[13]

As shown at the recent conference on capacity markets sponsored by the CPUC, the CAISO, and the Energy Oversight Board, there are a variety of approaches to capacity markets. WCP's vision of a capacity market for California emphasizes standardization and enforcement of real reliability requirements over the creation of new market bureaucracies. If the requirements are correctly established, a workable capacity market will develop. Capacity markets should have the following characteristics:

- Standard definitions of "qualified capacity" should be established for each resource type.
- The resource adequacy requirement should be met with the procurement of standardized capacity product.
- Standardized capacity product should be defined as physical generation

[13] Report, p. 20.

capable of producing deliverable energy. As the proposed decision on accelerating implementation of the resource adequacy requirement stated, "failure to be deliverable obviously undercuts the whole concept of resource adequacy."[14]

- Capacity procured to meet the resource adequacy requirement should seamlessly integrate with the CAISO markets. Capacity should either be scheduled a day ahead of operation, or it should be offered in the CAISO's day-ahead or real-time energy and ancillary services markets.

- The CAISO should be able to monitor and enforce the resource adequacy requirement and be able to levy penalties for noncompliance or to procure capacity to mitigate shortfalls.

E. Deliverability standards

The Committee also recognizes the need for power to be deliverable to customers. As the CPUC draft decision stated, a lack of deliverability "obviously undercuts the whole concept of resource adequacy."[15] This requirement has become so obvious that the Report endorses the development of deliverability standards without offering much discussion of the need for these standards.[16]

F. Timing

Timing will be critical in two respects.

First is the timing of the development of the initiatives identified in the Report. The Committee did a good job of identifying the three key initiatives that must be pursued to ensure that California's electric system continues to be reliable and stable—implementation of the resource adequacy requirement, development of a capacity market, and the articulation of

[14] Interim Opinion Regarding Resource Adequacy, Draft Decision of ALJ Wetzell, issued on August 31, 2004 in CPUC Rulemaking 04-04-003, p. 28.
[15] Interim Opinion Regarding Resource Adequacy, Draft Decision of ALJ Wetzell, issued on August 31, 2004 in CPUC Rulemaking 04-04-003, p. 28.
[16] Report, p. 3.

deliverability standards. However, the Report does not emphasize the crucial issue of the timing of these three elements. To ensure continued reliability of electric supply, these three initiatives should be developed and implemented simultaneously.

Timing is also important in a second respect. For the owners of aging power plants (like WCP), for other market participants, and for the consumers of electricity in California, time is of the essence. Some recent experiences underscore this point. On September 8, the CAISO set a new record peak demand of 45,597 MW. Two days later, both Southern California Edison and San Diego Gas & Electric Company set new records for peak demand. Fortunately for California, the rest of the western region was cooler that week and had energy available to sell to California. On the peak day, imported power set a new record of 9,116 MW. The seven records for peak demand set this year (so far) reflect the fact that load in California in 2004 has increased about 6.8% from 2003.

Despite the fact that California escaped from electric supply problems this year only because of the availability of an unusually large quantity of imported power, the CPUC does not appear to have a sense of urgency with regard to the actions that will help solve resource adequacy problems. The Draft Decision on resource adequacy defers action on deliverability screens, local reliability requirements, and compliance and enforcement issues to workshops in 2005.

Both the Energy Commission and the CPUC should understand that the owners of aging power plants don't have the luxury of leisurely decision-making. Aging power plant owners are making decisions right now about the operation of their plants in 2005 and beyond. If the state hopes to retain these aging power plants and the many benefits they have to offer the electric system, action is needed now.

G. The role of short-term contracts

The Report recognizes that one- to five-year contracts have a role to play in California's energy future, recognizing that "multi-year contracts could include aging power plants, to the extent they supply reliability services and provide cost-effective capacity resources,

as a bridge to bringing on new generation."[17] The Report expresses a concern, however, that these contracts might interfere with the construction of new power plants already licensed by the Commission. This concern is misplaced for several reasons.

First, short-term contracts will not displace new generation for the simple reason that California needs every in-state MW it can get, including existing and new generation, for the next 7-10 years. A sharp increase in the growth of demand, combined with the eventual retirements of some aging units, will ensure that there is a need for all in-state resources. A related second point is that the demand that will support short-term contracts is not matched geographically with already-permitted resources. As the Committee recognizes, "While the near-term need for resources appears to be in southern portion of the state, the vast majority of these plants that have been licensed, but not constructed are in northern part of the state."[18] Third, the longer-term contracts that will likely be awarded to new plants permit better financing arrangements and lower financing costs, making it unlikely that holders of short-term contracts will out-compete new generation on a price basis.

Moreover, two- to five-year contracts are ideal vehicles for achieving the goal of transitioning away from RMR contracts and for addressing local reliability issues. The Report correctly notes, "The CPUC directed the utilities in general to consider local reliability needs in their procurement plans rather than relying upon the CA ISO and/or RMR contracts."[19] Unfortunately, to date the utilities have been slow to respond to the CPUC's direction, and the use of short-term contracts to secure local reliability has not developed into the additional resource that the CPUC contemplated.

H. The role of repowering

One area where the Report was deficient was its failure to acknowledge and discuss the role that repowering—new generation units installed on the sites of existing plants—can play in solving California's energy problems. Many existing plants are located in load pockets, and generation in these load pocket sites is extremely valuable as a solution to local area

[17] Report, p. 21.
[18] Report, p. 14.
[19] Report, p. 24.

reliability problems. Short-term contracts can help meet local reliability needs on a short-term basis, but in the long term, repowerings are the best way to solve local reliability problems.

Repowering offers a number of benefits to consumers and to the electric grid. Repowering can quickly provide efficient, environmentally benign sources of new capacity. Existing sites have an existing footprint in the community and are often located near significant load centers. In many cases, load has "grown up" around existing sites and, thus, existing sites generate highly deliverable power that is crucial for maintaining reliability and can serve load without the addition of new electric transmission lines or natural gas laterals. Repowerings at existing sites are already interconnected to the gas transportation system, result in more efficient use of natural gas, produce fewer incremental environmental impacts (compared to new greenfield generation and to the aging power plants themselves), have in place measures to mitigate environmental impacts, raise fewer permitting or land use issues, and in most cases enjoy the support of the local community. Existing sites often already possess rights to water needed for cooling. Existing sites already have many of the permits required to operate a generation plant, which should allow them to come online more quickly than comparable "greenfield" plants.

Because of the value of repowering to maintaining and enhancing the reliability of the grid, on both a grid-wide and local basis, WCP urges the Commission to revise the Report to recommend that repowering should be expressly recognized in the loading order of the Energy Action Plan.

III. RECOMMENDATIONS AND CONCLUSION

WCP appreciates the opportunity to present its reaction to the Report to the Committee, and hopes the Committee has found WCP's comments helpful to the development of the 2004 IEPR Update.

WCP respectfully urges the Commission to take the following actions as it prepares the final 2004 Update Report:

- The final Report should expressly support repowering at the critical locations studied in the Aging Power Plant Study as good public policy for

California.

- The final Report should support expressly recognize repowering in the loading order of the Energy Action Plan.

- The final Report should state that some of the existing plant sites in the Los Angeles Basin are so critical to the electric transmission system that there will be a continued need for generation at those sites.

- The final Report should acknowledge that a standardized capacity product is critical to a successful capacity market, and that emphasis should be placed on requirements that facilitate the development of workable markets, rather than the creation of a new bureaucratic overlay.

- The final Report should advocate for capacity certification and counting rules for compliance with the resource adequacy requirement.

Respectfully submitted this October 13, 2004 at Sacramento, California.

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